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**University Examinations 2016/2017**

SECOND YEAR SECOND SEMESTER EXAMINATION FOR THE DEGREE OF

COMMERCE

THIRD YEAR FIRST SEMESTER BACHELOR OF BUSINESS IN PURCHASING

&SUPPLIES MANAGEMENT AND CO-OPERATIVE MANAGEMENT

**BEC 3250/BEC 3275: INTERMEDIATE MACROECONOMICS THEORY**

**DATE: DECEMBER 2016 TIME: 2HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two*** *questions*

**QUESTION ONE (30 MARKS)**

1. An economy shows the following features

Consumption C=80+0.8Yd

Where Yd = Disposable income

Tax T=60 + 0.2 Y

Where Y= National income

Investment I=200-10R

Where R=Percentage rate of interest

Transfers TR=40

Government expenditure G=160

Transaction and precautionary demand for money M1=0.4Y

Speculative demand for money M2=300-20R

Supply of money Ms=476

1. Calculate equilibrium value of Y and R (12 marks)
2. Is the government budget in surplus or deficit (8 marks)
3. What is the level of consumption at equilibrium level of income (10 marks)

**QUESTION TWO (20 MARKS)**

1. Distinguish between classicism and Keynesianism economic concepts (10 marks)
2. Discuss the limitations of monetary policy and fiscal policy in less developed economics like Kenya (6marks)
3. Explain the concept of the Philips curve (4marks)

**QUESTION THREE (20 MARKS)**

1. Explain the classical price adjustment mechanism (7 marks)
2. Explain the concept of liquidity trap and its implications to macroeconomic policy

(6 marks)

1. With aid of algebra explain and prove that the balanced budget multiplier is always equal to one (7 marks)

**QUESTION FOUR (20 MARKS)**

1. Distinguish between rational and adaptive expectations (4 marks)
2. Explain the following concepts as applied in economics
3. The accelerator theory (2 marks)
4. Crowding out effect (2 marks)
5. Explain the relevance of Milton fredman policy prescription of constant money supply growth model in ensuring economic stability (4 marks)
6. Discuss the monetary policy instruments applied by the central bank to achieve macroeconomic objective (8 marks)

**QUESTION FIVE (20 MARKS)**

1. Consider an economy described by the following functions: (think of the variable as being in billions of shillings at constant prices)

C = 50+0.8Yd

I = 70

G = 200

TR = 100

t = 0.20

1. Calculate the equilibrium level of income and the multiplier in this model

(3 marks)

1. Calculate also the budget surplus (2 marks)
2. Suppose that *t* increases to 0.25. What is the new equilibrium and new multiplier?

(5 marks)

1. Calculate the change in the budget surplus if c = 0.9 rather than 0.8? (5 marks)
2. Explain why the multiplier is 1 when t = 1 (5 marks)
3. Suppose the economy is operating at equilibrium, with Y0 = 1,000. If the government undertakes a fiscal change so that the tax rate t increased by 0.05 and government spending by 40 will the budget surplus rise or fall? Why? (5 marks)